IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 142 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA
HONOURABLE MS.JUSTICE H.N.DEVANI

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX - Applicant(s)

Versus

REWASHANKER A KOTHARI - Respondent(s)

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Appearance :
MR BB NAIK for Applicant(s) : 1,
None for Respondent(s) : 1,
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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MS.JUSTICE H.N.DEVANI

Date : 09/01/2006

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE D.A.MEHTA)

1.The Income Tax Appellate Tribunal, Ahmedabad

Bench “C” has referred the following two questions under Section 256(1) of the Income Tax Act, 1961 (the Act) at the instance of the Commissioner of Income Tax, Rajkot.

> “[1] Whether the Appellate Tribunal is right in law and on facts in setting aside the order made by the C.I.T. U/s 263 of the I.T. Act?
>
> [2] Whether the Appellate Tribunal is right in law and on facts in observing that the income was required to be taxed as capital gain and not as business income?”

2.The assessment year is 1987-88 and the relevant previous year is the year commencing on 1st July 1985 and ending on 30th June 1986. The assessee was originally assessed u/s 143(1) of the Act on 28-7-1987. The Commissioner of Income Tax, Rajkot (CIT) issued notice u/s 263 of the Act

on 19/2/1990. The assessee submitted a detailed reply dated 2/3/1990. However, the CIT passed an order on 12/3/1990 in the following terms:

> “[3]. The assessee's contentions have been considered. Considering the nature of this transaction year after year, it was clear that the assessee was doing business in shares and shares produced by him were also as stock in trade. Simply show in the shares as investment in the books cannot prove the contention of the assessee that shares were held as investment. What is to be seen is the intention of the assessee at the time of purchase of shares. Prima facie, it is clear from the records that the assessee was dealer in shares. The assessment was made u/s 143(1) and the Income Tax Officer did not inquire into the real nature of the transaction. Failure on the part of the Assessing Officer to

> inquire into the real nature of the transaction which prima facie appear in the nature of business resulted in an assessment which is erroneous and prejudicial to the interest of revenue. Besides, full facts were not on record when the I.T.O. made the assessment.
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> [4]. In view of the above facts, the assessment made by the Assessing Officer is set aside and he is directed to re-do the same after considering the above points and after giving the assessee reasonable opportunity of presenting his case."

3. The assessee carried the matter in appeal before the Tribunal. After hearing both the sides, the Tribunal made an order on 11/6/1992 holding that the CIT had incorrectly exercised jurisdiction under Section 263 of the Act and also, in the process, holding that, on facts, the Commissioner had failed to point out any error committed by the Assessing Officer.

4.Mr.B.B.Naik, the learned standing counsel appearing on behalf of applicant revenue has been heard. Though served, there is no appearance on behalf of respondent assessee.

5.Mr.Naik assailed the impugned order of Tribunal on two counts. Firstly, it was submitted that the Commissioner having merely sent back the matter to the Assessing Officer to re-do the assessment after considering the points stated by him in his order and after giving the assessee a reasonable opportunity of presenting his case, the Tribunal ought not to have interfered as no prejudice had been caused to the assessee. Secondly, it was contended that the Commissioner not having expressed any final opinion on merits of the matter, the Tribunal could not have entered into the discussion on merits. That the Tribunal had, therefore, incorrectly examined the facts of the case and

recorded findings on merits of the controversy.

6. As can be seen from the extracted portion of the order of Commissioner, he has expressed prima facie opinion to the effect that the assessee was doing business in shares and the shares purchased by the assessee were held as stock in-trade. By holding that the assessing officer had failed to inquire into the real nature of the transaction, the Commissioner also opined prima facie that the transactions available on record reveal that the assessee was a dealer in shares. It is in this context that when the contention raised by Mr.Naik herein was raised by the departmental representative before the Tribunal that Tribunal recorded that the order of Commissioner clearly contains clear expression of his opinion and the Commissioner has asked the assessing officer to re-do the assessment (after considering the above points), meaning

thereby, the points stated by the Commissioner in paragraph No.3 of his order.

7. However, even if one proceeds on the footing that the Commissioner had not expressed any opinion and had merely set aside the assessment while exercising powers under Section 263 of the Act, nonetheless when an appeal is preferred against such an order, the Tribunal is well within its jurisdiction to examine as to whether the Commissioner had rightly exercised jurisdiction under Section 263 of the Act. In other words, whether the assessment order made by the Assessing Officer could be treated to be erroneous and prejudicial to the interests of the revenue, which are the two pre-requisite conditions for assumption of jurisdiction under Section 263 of the Act. In this process, if the Tribunal examines the facts and evidence which were available on record before the Commissioner at the time of

framing of order under Section 263 of the Act, it cannot be stated that the Tribunal has committed any error in recording findings in relation to such facts and evidence on record. All that the Tribunal does is whether, in light of the record which was available before the Commissioner when he exercised the jurisdiction under Section 263 of the Act, it was possible to come to the conclusion that the assessment order was both erroneous and prejudicial to the interests of the revenue.

8. In the present case, the CIT exercised jurisdiction under Section 263 of the Act on the basic premise that the assessee was a dealer in shares and this is apparent from the show cause notice issued by CIT under Section 263 of the Act. The CIT had categorically stated that, on examination of the records in the case of the assessee, it was noticed that the assessee had been showing income under the

head “capital gains” on sale of shares year after year from assessment year 1982-83, and that, in previous year relevant to assessment year 1982-83, the assessee only had 20 shares in stock. On this basic premise, the Commissioner issued show cause notice on 19/2/1990 and the assessee replied on 2nd March 1990. As can be seen from the reply tendered by the assessee, the assessee had factually disputed that it had more than 20 shares in the previous year relevant to assessment year 1982-83 and for this purpose, it invited attention not only to the accounts, but also to the chart attached to the reply tendered before the Commissioner. These documents were available on record of the Tribunal.

9. Upon examination of the aforesaid record, the Tribunal recorded that the assessee had given an effective answer to the show cause notice and thereafter, proceeded to record the

following findings :

(1).There was a large time gap between the dates of acquisition of the shares and the sale thereof.

(2).Thus, the intention to sell cannot be inferred at the point of time of the purchase.

(3).That merely because the sale had resulted in a profit did not mean that when the assessee purchased the shares, it was with an intention to sell them at a profit.

(4).That an investor may sell the shares when he gets a good price for the shares.

(5).That the assessee had shares in 25 to

30 companies and the value of the total holding was between Rs.57,000/- and Rs.63,000/-, which was very small amount considering the number of companies in which the shares were held, thus, denoting that the assessee was a small investor.

(6).That number of transactions are not many every year and the assessee could not be said to indulge in several transactions of purchase and sale every year.

10.The tests laid down by various decisions of the Apex court indicate that, in each case, it is the total effect of all relevant factors and circumstances that determine the character of the transaction. Each case has to be determined on the total impression created on the mind of the Court by all the facts and

circumstances disclosed in a particular case. One of the principal tests is whether the transaction is related to the business normally carried on by an assessee. The nature of the commodity would also be a relevant factor. It is equally well settled that, merely because the original purchase was made with the intention to re-sell, if an enhanced price could be obtained, that by itself is not enough to infer that an assessee is carrying on business. However, though profit motive in entering into a transaction is not decisive, if the facts and circumstances indicate that the purchase of the asset was made solely and exclusively with an intention to re-sell the asset at a profit, it would be a strong factor for inferring that the transaction was in the nature of business.

11.In the case of Pari Mangaldas Girdhardas v. Commissioner of Income Tax, 1977 CTR (Guj.)

647, after analyzing various decisions of the Apex Court, this Court has formulated certain tests to determine as to whether an assessee can be said to be carrying on business.

> [a] The first test is whether the initial acquisition of the subject matter of transaction was with the intention of dealing in the item, or with a view to finding an investment. If the transaction, since the inception, appears to be impressed with the character of a commercial transaction entered into with a view to earn profit, it would furnish a valuable guideline.
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> [b] The second test that is often applied is as to why and how and for what purpose the sale was effected subsequently.
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> [c] The third test, which is frequently applied, is as to how the assessee dealt with the subject matter of transaction during the time the asset was with the assessee. Has it

been treated as stock in-trade, or has it been shown in the books of account and balance sheet as an investment. This inquiry, though relevant, is not conclusive.

[d] The fourth test is as to how the assessee himself has returned the income from such activities and how the department has dealt with the same in the course of preceding and succeeding assessments. This factor, though not conclusive, can afford good and cogent evidence to judge the nature of transaction and would be a relevant circumstance to be considered in absence of any satisfactory explanation.

[e] The fifth test, normally applied in cases of partnership firms and companies, is whether the Deed of Partnership or the Memorandum of Association, as the case may be, authorises such an activity.

[f] The last but not the least, rather the most important test, is as

> to the volume, frequency, continuity and regularity of transactions of purchase and sale of the goods concerned. In a case where there is repetition and continuity, coupled with the magnitude of the transaction, bearing reasonable proportion to the strength of holding, then an inference can readily be drawn that the activity is in the nature of business.

12. On the application of the aforesaid tests, if the matter is examined, it is apparent that not only the Tribunal has applied the correct tests, but has drawn the right inference. The findings of fact recorded by Tribunal on the basis of evidence available before it cannot be termed to be without any evidence, and once this is so, it is not possible to state that the Tribunal committed any error when it came to the conclusion that the assessment order was not erroneous. That as a consequence, CIT could not have assumed jurisdiction under Section 263 of the Act. As already stated

hereinbefore, once an assessee has exercised its right to file a statutory appeal against the order of CIT made under Section 263 of the Act, the Tribunal is bound to examine whether CIT had rightly invoked provisions of Section 263 of the Act. The basic requirement for this is satisfaction of the twin conditions envisaged by the section, namely, the assessment order must be erroneous and prejudicial to the interests of revenue. It is equally well settled that if the assessing officer has taken a view of the matter which is reasonably possible in the factual matrix, the CIT cannot exercise powers under Section 263 of the Act, merely because it is possible to record a different conclusion on the same set of facts and circumstances.

13. On facts, the Tribunal has also taken note of the fact that there was a long gap between the date of acquisition of the shares and their

sale and that some of the shares sold in the relevant accounting period were purchased at least 3 years ago, while some other shares were purchased as far back as in 1971 i.e. a period of about 14 to 15 years. Furthermore, in the reply to the show cause notice issued, the assessee has categorically stated that he is a partner in a firm having business of building materials, hardware items etc. and neither the firm nor the assessee are carrying on any business in shares. That the assessee had been duly filing wealth-tax returns right from assessment year 1957-58 and the share holding on respective valuation dates has duly been shown as wealth on account of investment. These facts have not been disputed by the CIT.

14. Therefore, in light of what is stated hereinbefore, the impugned order of Tribunal does not suffer from any infirmity. The Tribunal has rightly come to the conclusion

that the order made by CIT under Section 263 of the Act is not sustainable, and that, on facts, the income was required to be taxed under the head “capital gains” and not as “income from business”. In the result, both the questions are answered in the affirmative i.e. in favour of the assessee and against the revenue.

15.The Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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